BALCH & BINGHAM LLP

Alabama • Georgia • Mississippi • Washington, DC

Riley W. Roby
(334) 269-3120

Attorneys and Counselors
The Winter Building
2 Dexter Avenue
P.O. Box 78 (36101-0078)
Montgomery, Alabama 36104-3515
(334) 834-6500
(334) 269-3115 Fax
www.balch.com
(877) 453-6422 (direct fax)
rroby@balch.com

November 23, 2004

BY HAND DELIVERY

Mr. Walter Thomas
Secretary
Alabama Public Service Commission
RSA Union Building
8th Floor
100 N. Union Street
Montgomery, Alabama 36104

TELECOMMUNICATIONS FILED NOV 24 2004 APSC

SECRETARY Filed NOV 23 2004 APSC

Re: Proposed Revisions to the Price Regulation and Local Competition Plan; Docket No. 28590

Dear Mr. Thomas:

Enclosed herewith for filing are the original and ten copies of AT&T Communications of the South Central States, LLC's Response to Order Seeking Comments on the Revised ATRP in the above-referenced matter.

Very truly yours,

Riley W. Roby

Riley W. Roby

RWR:dpe
Enclosures

cc: Counsel of Record

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BEFORE THE
ALABAMA PUBLIC SERVICE COMMISSION

In Re: Proposed Revisions to the	)	
Price Regulation and Local	)	**Docket No. 28590**
Competition Plan	)	

AT&T RESPONSE
TO ORDER SEEKING COMMENTS ON THE REVISED ATRP

AT&T Communications of the South Central States, LLC ("AT&T"), pursuant to the Commission's Order dated November 5, 2004, provides the following comments regarding the Revised Alabama Telecommunications Regulation Plan ("Revised ATRP").

Previously in this docket, AT&T and others filed extensive comments and reply comments showing that the current state of local exchange competition in Alabama did not warrant further relaxation of regulatory rules for incumbent local exchange carriers ("ILECs"). The ILECs have attempted to justify a "need" for further relaxation of regulatory rules by giving examples of developing competition, but not once do any of the ILECs show how the Commission's existing rules prevent them from competing effectively in the marketplace. Moreover, recent actions by the U.S. Court of Appeals and the FCC cast serious doubt on the future availability of the most economic and most used means of competitive entry – UNE-P. To the extent that local exchange competition has developed at all in Alabama, it is due in large part to the availability of UNE-P. The absence of the full availability of UNE-P at cost-based rates will have a detrimental effect on the future development of local exchange competition in Alabama and this Commission should not extend further relaxed regulation to ILECs until the full impact of the actions taken at the federal level are known. Without specifically restating each point, AT&T hereby incorporates by reference in this Response all of the arguments it set forth in its previously filed Initial Comments and Reply Comments previously filed with this Commission.

PARTS I AND III
BELLSOUTH AND ILEC PRICING FLEXIBILITY PLANS

The objectives set by the Commission in its 1995 Price Regulation and Local Competition Order[1] ("1995 Order") remain valid, but the proposed regulations are not fully compliant with those objectives. The objectives of the 1995 Order are:

1. To create an environment in which fair and effective local competition flourishes.

2. To encourage the introduction of new technology and modern services in all areas of Alabama, both urban and rural.

3. To protect customers from unjust prices for telephone services and from deterioration of telephone service quality.

4. To establish price regulation procedures which allow the Commission to fulfill its regulatory responsibilities during the transition to a fully competitive local telecommunications marketplace.

5. To ensure universal access to telephone service in all areas of Alabama.

6. To streamline regulatory procedures, where feasible, which might encumber new entrants and incumbent providers of telecommunications services in the transition to a competitive marketplace.

7. To develop a plan which is dynamic and capable of responding to changes in legislation, new ideas, and evolving market conditions.

The Revised ATRP freezes switched access rates at the existing intrastate levels, which is contrary to the objectives of the 1995 Order because it is neither creating an environment in which 'fair and effective local competition flourishes' (Objective 1), nor developing a plan that is responding to evolving market conditions (Objective 7). The

[1] Price Regulation and Local Competition Order, Docket Nos. 24499, 24472, 24030 and 24865, Sept. 20, 1995.

plan totally ignores the fact that BellSouth continues to own and operate what is, for all practical purposes, a post 271 monopoly local telephone network. The Revised ATRP, in essence, provides BellSouth nearly unfettered ability to set the rates and terms other carriers must pay for access to and use of BellSouth's network. Because BellSouth sets its switched access rate well above its economic cost of providing access, such rate is anti-competitive, discriminatory, economically inefficient and contrary to sound public policy.

As long as BellSouth's switched access rate remains well above BellSouth's economic cost of providing access, BellSouth can price its own retail services well below the access rate it charges long distance carriers who compete with BellSouth. Thus, BellSouth can price other carriers out of the market, not because these other carriers are less efficient than BellSouth, but merely because the artificially high rate BellSouth charges for access to its network keeps long distance carriers' prices needlessly high when compared to BellSouth's charges for similar services.

Requirements to impute costs do not "solve" this problem because imputed costs are not real costs to BellSouth, but simply revenues that BellSouth keeps. Accordingly, a cost imputation analysis does not in any way ensure that BellSouth cannot leverage its monopoly power to harm competition. By imputing costs, BellSouth does nothing more than move revenues from one set of BellSouth books to another. Accordingly, BellSouth's switched access rate provides BellSouth an artificial and unfair advantage when BellSouth provides toll and other services. BellSouth's switched access rate strengthens an already unfair advantage in interexchange services provided in Alabama today.

In addition to being anti-competitive, BellSouth's switched access rate also is discriminatory. BellSouth's rate for switched access should be no different than its prices for local interconnection and unbundled network elements. This is because the transport and termination functions BellSouth performs to terminate its own local calls are the same functions BellSouth performs when it originates or terminates intrastate long distance calls for AT&T and other long distance carriers. Local interconnection and access perform the same function and provide the same basic service access to BellSouth's local network. There is no reason why identical functions should not be priced identically. Indeed, they should be priced identically. Nevertheless, BellSouth charges one rate for local interconnection and a different, higher rate for switched access.

At the interstate level in particular, experience has shown that competition has not controlled special access pricing and, in fact, where given added flexibility, BellSouth has greatly increased prices. Competition for special access has not held down prices. To squelch increasing special access pricing, special access should be capped at the existing intrastate rates and then reduced to the UNE equivalent pricing, rather than provide BellSouth with increased flexibility.

Because BellSouth and Century Telephone are not compliant with the 1995 Order's requirements for switched access service, there is no valid reason to allow higher access rates in revised plans than the 1995 Order required. With ILECs in the long distance market, it is imperative that access rates be based on forward-looking economic costs. The Revised ATRP and regulation plans must provide for access reductions. Treating "a minute is a minute is a minute" will also remedy discriminatory treatment of IXCs vs. CMRS providers (such as Cingular). There is simply no principled reason to retain a "rate design" that taps long distance voice traffic to advance a policy objective for which no other type of traffic is required to pay. Forcing interexchange carriers to bear this burden is discriminatory.

One way to move away from the present discriminatory access pricing is to implement "toll-centric" reform, a *permissive*, market based option that would allow the ILECs to recover revenue lost from reducing intrastate switched access rates. That is, the ILECs (if they chose to do so) could recover lost access revenue through a new retail access charge that would be applied on a per minute of use basis to its local customers that make toll calls (regardless of the IXC). The charge would be permissive and limited to those local customers making toll calls. AT&T proposed this solution to the Commission Staff in a recent response to the rural ILECs' proposed Alabama Access Reduction Fund. Implementation of this toll-centric reform of access would enable the rural ILECs to implement the Local Calling Plan options that they are currently considering. A complete copy of AT&T's response to the proposed Alabama Access Reduction we previously provided to the Staff and is attached hereto as <u>Appendix 1</u>. Alternatively, the Commission could implement a *non-discriminatory* state universal service plan that moves the "lost" access revenues into the USF.

PART IV ATRP
CLEC PRICE FLEXIBILITY PLAN

I. General

As an initial matter, the regulation of telecommunications carriers should be commensurate with their market power[2]. Competitive local exchange carriers ("CLECs")

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[2] Several factors generally are considered in assessing market power. These include: barriers to entry; supply capabilities of competing participants; availability of substitutable services; the number and financial strength of competing participants; the relative power of purchasers; rate of return; and the

do not have market power and should not be regulated the same as the ILECs. CLECs come to the market without an established customer base, must make initial capital investments to serve end users and/or are dependent on the use of the incumbents' facilities in order to provide services to their end-users. The existing rules recognize these distinctions in the Commission's decision to treat new entrants differently in order to encourage the development of local exchange competition. For example, Section 19.02 of the 1995 Order states that:

> "To create an environment in which fair and effective local competition flourishes, regulatory requirements for new entrants will initially be kept to a minimum in order to prevent unnecessary barriers to effective competition."[3]

There should be a significant difference in the regulatory treatment of ILECs vs. CLECs when local markets are opened to competition. New entrants should be subject to minimal regulation because they lack market power. The basis for distinguishing levels of regulation is the difference in market power between ILECs and CLECs, which remains sizeable in favor of ILECs and may continue for many years to come, despite the authorization of competition in local markets. Given the existing Alabama market conditions, it is appropriate for the Commission to forbear from applying the proposed CLEC regulations until such time as the CLECs' market power is comparable to that of the ILECs. This forbearance should apply to the proposed tariff requirements, the pricing rules, contract service arrangements, promotions, customer value programs, marketing/technical trials & bundled services, service quality, customer notification, and

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movement of market share over time. Before the market power of ILECs can be eliminated, (i) artificial and unique barriers to entry must be removed; (ii) more than one alternate source of supply must be widely available; and (iii) alternate providers must be able to serve a substantial portion of total demand. In addition, the absence of market power should be clearly demonstrated by a significant decrease in an ILEC's market share.

[3] See Footnote 1 above.

reporting and filing requirements. Such forbearance is consistent with and supports the objectives of the 1995 Order.

II. Specific Provisions

As set forth above, the Commission should forbear from applying the proposed CLEC rules at the present time. However, if the Commission does apply some version of the proposed rules to CLECs, it should make changes to specific provisions of Part IV in recognition of the different status of CLECs and ILECs.

Section 3C – Tariffs

This section refers to price increases and has different notice (Effective Date) requirements for different "Tiers". The Commission should not apply the Tier concept to CLECs. The Tier concept is a BellSouth creation to make it more politically acceptable to achieve the deregulation that it is seeking. A Tier is defined as "a category of wire centers demonstrating similar levels of competitive activity..." Tier I was designed by BellSouth to reflect the highest degree of competitive activity and thus to have the least amount of regulation. According to the Revised ATRP, wire centers move from Tier III to Tiers II and I according to the level of competitive activity.[4] By definition, CLECs face the highest level of competition – i.e., from the ILECs – wherever they enter the market. Consequently, every wire center is a Tier I market for CLECs. CLECs should not have to be made to determine in which "ILEC Tier" their customers reside in order to determine the appropriate Effective Dates of their tariffs. It simply makes no sense to burden new entrants with additional and complex regulatory rules that are designed for

[4] "Competitive activity and not geographical affiliation ultimately determines wire center assignment", (Proposed Rules Part I, Section 3).

ILECs and meaningless for CLECs. The Effective Date for CLEC price changes, regardless of the wire center location, should be no more that 1 day after the file date.

Section 5 – Contract Service Arrangements

This section requires CLECs to comply with the rules in the ILEC service area where the affected CLEC customers are located. Again, there are different rules for different Tiers. For the reasons stated above, the Tier concept should not be applicable to CLECs. In addition, the proposed rules require ILECs to provide extensive information concerning contract service arrangements on a monthly basis. This information includes customer identification, price differentials, cost support, and details about competitive alternatives if the customer is located in Tiers II or III. While this information may be helpful in tracking the activities of incumbent monopoly providers, it has no rational basis for application to new market entrants. Having to comply with these requirements is overly burdensome for new entrants and could very well have a chilling effect on new market entry. As such, it is arguably in violation of section 253(a) of the Telecommunications Act of 1996.[5]

Section 9 – Reporting and Filing Requirements

A. This subsection requires CLECs to establish web access for the Commission Staff to Commission approved tariffs or the electronic filing of complete updated tariffs every time a change is approved. In addition, the proposed rule requires submission of updated archived tariffs. These requirements are costly and burdensome to CLECs and should not be approved. Alabama law requires the filing of tariffs that are charged by the telephone utility. However, there is no provision of law that allows the

[5] "No State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service." Add cite.

Commission to require the filing of rates, terms and conditions that are no longer in effect.

C. A requirement to file the name and location of pay phone service providers and shared tenant service (STS) access lines served on a wire center basis is burdensome and unnecessary and should be rejected.

Section 14 – Commission Oversight

This section appears to be applicable to all Parts of the proposed rule and out of place in the CLEC section. It should be relocated at the very end of the Revised ATRP and the remaining sections of Part IV should be renumbered accordingly.

PART V
TOLL SERVICE PROVIDER STREAMLINED REGULATION PLAN

Section 5A and B – Reporting and Filing Requirements

These are the same requirements applicable to CLECs in Part IV, section 9. For the same reasons set forth above, these requirements should be rejected.

CONCLUSION

For the reasons set forth above, the Commission should refrain or forbear from applying the Revised ATRP to CLECs and should, to the extent it allows any further relaxed regulation of ILECs, require immediate reductions in intrastate switched access rates to cost-based levels.

Respectfully submitted this 23rd day of November 2004.

Riley W. Roby (ROB137)
One of the Attorneys for AT&T
Communications of the South
Central States, LLC

OF COUNSEL:
Robin G. Laurie (LAU006)
Riley W. Roby (ROB137)
Balch & Bingham LLP
P. O. Box 78
Montgomery, Alabama 36101

CERTIFICATE OF SERVICE

I hereby certify that I have served a copy of the foregoing upon the following individuals in this cause by placing the same in the U.S. Mail, postage prepaid and properly addressed this 23rd day of November 2004.

Francis B. Semmes, Esq.
General Counsel - Alabama
BellSouth
Suite 28A2
600 North 19th Street
Birmingham, Alabama 35203

Mark D. Wilkerson, Esq.
Brantley, Wilkerson & Bryan P.C.
405 S. Hull Street
P.O. Box 830
Montgomery, Alabama 36101-0830

Olivia W. Martin, Esq.
Assistant Attorney General
Office of the Attorney General
Utilities Section, Civil Division
Alabama State House
11 South Union Street
Montgomery, Alabama 36130

Peter S. Fruin, Esq.
Maynard, Cooper & Gayle, P.C.
Suite 1650
201 Monroe Street
Montgomery, Alabama 36104

Nanette S. Edwards
Director
ITC^DeltaCom
4092 S. Memorial Parkway
Huntsville, Alabama 35802

Mario Soto, Esq.
BellSouth Long Distance, Inc.
400 Perimeter Center Terrace
Suite 350
Atlanta, Georgia 30346

Chad S. Wachter, Esq.
Knology, Inc.
1241 O.G. Skinner Drive
West Point, Georgia 31833

OF COUNSEL

1514042

November 18, 2004

Tom Jones
Alabama Public Service Commission
100 North Union Street
Suite 850 RSA Building
Montgomery, Alabama 36130

Re: Alabama Access Reduction Fund Proposal

Dear Mr. Jones,

AT&T Communications of the South Central States, LLC (AT&T) provides the following information in response to your request for AT&T's position regarding the proposed Alabama Access Reduction Fund (AARF).

The proposed AARF is a plan designed by the small rural ILECs to establish a fund to support the cost of providing local exchange service. This fund would be a fixed amount of money and contributions to the fund would be imposed only on those firms providing interexchange services. The size of the fund would be determined by the aggregate size of the intrastate switched access rate reductions made by the rural ILECs. In other words, the proposal is to remove the implicit support that is currently embedded in switched access rates and to make that support explicit in the form of the AARF. Thus, regardless of the label that is given to this fund, it has all the characteristics of – and indeed is – an attempt to establish an Alabama universal service fund. As such, it must meet all the requirements required by law for universal service funds.

The proposed AARF falls short of meeting the legal requirements of a universal service fund in at least two respects and would therefore be subject to reversal on appeal if adopted by the Commission. First, the AARF is to be funded by only those carriers that provide interexchange services, i.e., those carriers that pay access charges. Second, it appears that ILECs are the only companies that can draw from the fund regardless of how many competitive local exchange companies may be providing services in the area. The Telecommunications Act of 1996 (the "Act") is clear and unambiguous regarding the establishment of state universal service funds:

> A State may adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service. ***Every*** telecommunications carrier that provides intrastate telecommunications services shall contribute, on an equitable and nondiscriminatory basis...[1] (emphasis added).

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[1] Telecommunications Act of 1996, Section 254(f).

The Act is clear that state universal service funds must require contributions from every provider of telecommunications services including all ILECs. The proposed AARF runs afoul of this requirement by limiting contributions to the fund to only those companies that provide interexchange services. By excluding certain ILECs, the fund is neither equitable nor nondiscriminatory. In addition, the proposal precludes withdrawals by any company except for ILECs – presumably the small rural ILECs. This limitation is not competitively neutral, is discriminatory and would constitute a violation of Sections 253(a) and (b) of the Act:

> (a) No State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service."
> (b) Nothing in this section shall affect the ability of a State to impose, on a competitively neutral basis and consistent with section 254, requirements necessary to preserve and advance universal service...

The Kansas Corporation Commission (KCC) attempted to implement a fund similar to the proposed AARF – a fund that provided explicit state subsidies to incumbent LECs to offset their revenue loss from reducing intrastate access charges. Western Wireless Corporation filed a petition with the FCC challenging the action by the KCC. Although the KCC changed its rules before the FCC released its opinion rendering the initial petition moot, the FCC nevertheless issued its order anyway "to provide guidance on these critical universal service issues which may well arise in other contexts..."[2] After finding that a new market entrant faces a substantial barrier to entry if its main competitor is receiving support that is not available to the new entrants and that it is unreasonable to expect an unsupported carrier to enter a high-cost market and provide a service that its competitor already provides at a substantially supported price,[3] the FCC stated:

> It appears doubtful that a program which limits eligibility for universal service funding to ILECs would be found competitively neutral, and thus within the authority reserved to the states in section 253(b). "[S]ection 253(b) cannot save a state legal requirement from preemption pursuant to sections 253(a) and (d) unless, *inter alia*, the requirement is competitively neutral with respect to, and as between, *all* of the participants and potential participants in the market at issue." (citation omitted).[4]

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[2] In the Matter of Western Wireless Corporation Petition for Preemption of Statutes and Rules Regarding the Kansas State Universal Service Fund Pursuant to Section 253 of the Communications Act of 1934, File No. CWD 98-90, Memorandum Opinion and Order released August 28, 2000. A copy of the FCC's Memorandum Opinion and Order is attached as Exhibit A.

[3] *Id.* at paragraph 8.

[4] *Id.* at paragraph 10.

The South Carolina Public Service Commission also implemented a similar fund to offset access reductions by the small rural ILECs. This fund is called the "Interim LEC fund and is currently under challenge by AT&T in a proceeding pending before the FCC based on the Kansas Memorandum Opinion and Order.[5] Because the initial Kansas plan, the South Carolina plan and the proposed AARF are functionally identical, it must be concluded that the proposed AARF is also unlawful. It makes no difference what title is applied to these plans. The intent, purpose and structure of all three plans are the same and do not pass legal muster.

ALTERNATIVE POLICY CONSIDERATIONS

The rural ILECs are concerned about losing minutes and associated support for providing basic local exchange service – both toll and switched access minutes – to competition (primarily from wireless carriers). However, the solution is not to allow the rural ILECs to continue to strap wireline toll competitors with above-cost access rates or to create a separate fund to "freeze" those revenues. Such charges already put those toll competitors at a severe disadvantage in the "all distance" market compared to wireless carriers who do not pay access charges. Instead, the remedy is to place all wireline competitors in Alabama on an equal footing with both the rural ILECs and the wireless carriers – by setting intrastate switched access rates to reciprocal compensation levels and, only if necessary, giving the rural ILECs a competitively neutral way to recover any real revenue need caused by reduced access charges.

Many state commissions, including the APSC, have been reluctant to reduce intrastate switched access rates based in part on ILEC contentions that every penny of access revenue is necessary to support basic local service and that the concept of universal service would collapse (and local rates would skyrocket) if access rates were reduced. This "worst case" scenario should not be blindly accepted.

That said, however, the Commission could implement a *permissive*, market based option that would allow the rural ILECs to recover revenue lost from reducing intrastate switched access rates. This solution, first articulated by the Staff of the Washington Utilities and Transportation Commission is a "toll centric" rather than a local centric approach.[6] That is, the rural ILECs (if they chose to do so) could recover lost access revenue through a new retail access charge that would be applied on a per minute of use basis to its local customers that make toll calls (regardless of the IXC). The charge would be permissive and limited to those local customers making toll calls. This solution removes any and all implications for local service increases, increased universal service subsidies, confiscation, piecemeal ratemaking, loop allocation concerns, and /or the specter of the consumer that does not make any toll calls subsidizing those that do. Thus,

[5] See In the Matter of AT&T Corp. Petition for Preemption, Pursuant to Section 253 of the Communications Act and Common Law Principles, of South Carolina Statutes that Discriminate Against New Entrants, CC Docket No. 96-45.

[6] See Washington State Utilities Commission Docket No. UT-020406, Direct Testimony of Glenn Blackmon, PhD. on behalf of the Commission Staff dated September 30, 2002.

it implicates none of the alleged policy harms that have stood in the way of access charge reform in the past. Finally, this policy option allows the rural ILECs some of the regulatory relief they seek in that the new charge would be permissive and the rural ILECs would decide just how much, if any, access revenue is actually needed to support universal service in Alabama. A summary background setting forth the reasonableness and justification of such an approach is attached as Exhibit B.

The Commission should consider this approach as a viable alternative solution to the dilemma the rural ILECs are trying to address through the unlawful structure of the proposed AARF.

Richard Guepe

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Western Wireless Corporation	)	File No. CWD 98-90
Petition for Preemption of	)	
Statutes and Rules Regarding the	)	
Kansas State Universal Service Fund	)	
Pursuant to Section 253	)	
of the Communications Act of 1934	)	

MEMORANDUM OPINION AND ORDER

Adopted: August 18, 2000 **Released:** August 28, 2000

By the Commission: Commissioner Furchtgott-Roth concurring in part, dissenting in part, and issuing a statement.

I. INTRODUCTION

1. Kansas has enacted the Kansas Telecommunications Act (Kansas Act) and the Kansas Corporation Commission (KCC) has promulgated regulations to implement local exchange competition and promote universal service in the state. On July 20, 1998, Western Wireless Corporation (Western Wireless), a provider of commercial mobile radio service (CMRS) in Kansas, filed a Petition for Preemption asking the Commission to preempt those provisions of the Kansas Act and regulations that limited the ability of carriers other than incumbent local exchange carriers ("non-ILECs") to receive universal service support. Subsequent to Western Wireless' filing, the KCC adopted new regulations for determining and allocating universal service support that, among other things, make all such support fully portable among competing carriers in Kansas. With this Memorandum Opinion and Order, we therefore dismiss the Western Wireless petition as moot. However, in order to provide guidance on these critical universal service issues, which may well arise in other contexts, we briefly discuss certain concerns that similarly structured programs may easily run afoul of Section 253 of the Communications Act.

II. BACKGROUND

2. On May 17, 1996, Kansas enacted the Kansas Act to implement local exchange competition and promote universal service in that state.[1] Section 66-2005(c) of the Kansas Act requires all local exchange carriers in Kansas to reduce their intrastate access charges to interstate rate levels. The statute authorizes the KCC to offset the access charge and toll charge reductions required by the Kansas Act through rebalancing of local residential and business rates, with any remaining portion initially being paid out from the Kansas Universal Service Fund (KUSF or Fund).[2] Section 66-2008(a) of the Kansas Act

[1] K.S.A. 1996 Supp. 66-2001 *et seq*. The Kansas Act went into effect on July 1, 1996.

[2] K.S.A. 1996 Supp. 66-2005(c).

states that "[t]he initial amount of the KUSF shall be comprised of local exchange carrier revenues lost as a result of rate rebalancing" pursuant to section 66-2005(c) and that such revenues shall be recovered on a revenue-neutral basis.[3] Section 66-2008(d) requires the KCC to periodically review whether changes in the cost of providing service justify modification of the KUSF, and, if so, modify the KUSF accordingly.[4] Section 66-2008(b) also requires all telecommunications providers, including wireless providers, to contribute to the KUSF on an equitable and nondiscriminatory basis.[5] Section 66-2008(c) states that distributions from the KUSF shall be made in a competitively neutral manner to qualified telecommunications public utilities, telecommunications carriers, and wireless telecommunications providers that are deemed eligible under section 214(e)(1) of the Communications Act by the KCC.[6] Sections 66-2008(e) and (f) allow "[a]ny qualified telecommunications carrier, telecommunications public utility or wireless telecommunications service provider" to request supplemental funding from the KUSF.[7]

3. On December 27, 1996, the KCC issued an Order which, among other things, implemented the Kansas Act and established the KUSF.[8] Pursuant to section 66-2008(a), the KCC initially sized the KUSF at $111.6 million, the amount of revenues it found that the ILECs lost as a result of intrastate access rate reductions mandated by the Kansas Act.[9] As explained by the KCC in its comments in this proceeding, the KUSF, at least initially, was comprised of two components -- a High Cost Funding program and a Rate Cut Funding program. Under the High Cost Funding program, all ETCs were eligible to receive support up to $36.88 for each residential or single business line they serve in rural areas, defined

3 K.S.A. 1996 Supp. 66-2008(a).

4 K.S.A. 1996 Supp. 66-2008(d)

5 K.S.A. 1996 Supp. 66-2008(b) Wireless carriers, however, do not have to make contributions from the intrastate revenue derived from calls that originate and terminate entirely over a wireless network. K.S.A. 1996 Supp. 66-2008(b); *see also* Order No 5, "Establishing Carrier Assessment Rate for Year 2000 KUSF Contributions," KCC Docket No. 00-GIMT-236-GIT at 10, ¶¶ 18-19 (January 19, 2000) (January 2000 KCC Order).

6 K.S.A. 1996 Supp 66-2008(c). Under section 214(e)(1), 47 U.S.C. § 214(e)(1), carriers that are designated as eligible telecommunications carriers (ETCs) under section 214(e) shall be eligible to receive universal service support.

7 Section 66-2008(e) provides for supplemental funding based on an increase in a carrier's access lines. K.S.A. 1996 Supp. 66-2008(e). Section 66-2008(f) provides that the KCC may, at its discretion, provide supplemental funding for other reasons. K.S.A. 1996 Supp. 66-2008(f).

8 General Investigation Into Competition Within the Telecommunications Industry in the State of Kansas, Docket No. 190,492-U, 94-GIMT-478-GIT, *Order* (KCC, rel. Dec. 27, 1996) (1996 KCC Order), *aff'd in pertinent part on recon* (KCC, rel. Feb. 3, 1997) (1997 KCC Reconsideration Order). Several parties, including wireless carriers, appealed these orders in the Kansas state court system. Although the Kansas Court of Appeals reversed the orders, the Kansas Supreme Court affirmed these orders in their entirety. *See Citizens' Util. Ratepayer Bd. v. State Corp. Comm'n*, 943 P.2d 494 (Kan. Ct. App. 1997); *Citizens' Util. Ratepayer Bd. v. State Corp. Comm'n*, 956 P.2d 685, 700 (Kan. 1998).

9 KCC Order, ¶¶ 106, 112. The size of the KUSF has subsequently been adjusted and was estimated to be $96.3 million for the March 1999 to February 2000 period. *See* Letter from James H. Lister, counsel for KCC, to David H. Krech, FCC, dated May 4, 1999 at 2; Letter from James H. Lister, counsel for KCC, to David H. Krech, FCC, dated May 11, 1999.

by the KCC as exchange areas with 10,000 or fewer access lines.[10] In addition, in order to implement the revenue neutrality requirement of the Kansas Act,[11] the Rate Cut Funding program provided ILECs additional support based on their revenues lost due to intrastate access charge reform. This support was based on the ILECs' statewide lines, and was thus not limited to "high cost" areas but was available to the ILECs - - and only the ILECs - - for lines they serve anywhere in the state.[12] The KCC also stated that a portion of the revenue-neutral support for ILECs would be designated as the amount per residential loop or "high cost" support.[13] Thus, the high cost support payment, according to the KCC, was "not in addition to the Rate Cut Funding."[14] In the first two years of the Fund, the KUSF distributed approximately $158 million, of which approximately $152 million, or 96 percent, was distributed to ILECs to offset the revenues they lost due to intrastate access charge reform.[15]

4. On July 20, 1998, Western Wireless filed a Petition for Preemption asking the Commission to declare that section 253 of the Communications Act of 1934, as amended,[16] preempted the provisions of the Kansas Act and the accompanying rules adopted by the KCC that served to limit the ability of carriers other than ILECs to receive universal service support under the Rate Cut Funding program in exchange areas with more than 10,000 access lines.[17] Western Wireless alleged that the Kansas Act and 1996 KCC Order violated sections 253(a) and 254(f) of the Communications Act because the KUSF's Rate Cut Funding program discriminated against new entrants and deterred competitive entry.[18] Western Wireless further alleged that the Kansas Act and 1996 KCC Order were not protected by section 253(b) because the Rate Cut Funding program was not competitively neutral and not related to the cost of providing universal service.[19] Fifteen parties filed comments on the Western Wireless petition and 11 parties filed reply

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10 1996 KCC Order, ¶¶ 123-125 The KCC used rural areas as a proxy for high cost areas

11 *See* K.S.A. 1996 Supp. 66-2008(c) The KCC interpreted this provision to require that funds should be distributed so that the ILECs would not initially lose revenue as a result of access charge reform. 1996 KCC Order, ¶ 124

12 KCC Comments at 3

13 1996 KCC Order, ¶ 124.

14 KCC Comments at 4.

15 *See Performance Audit Report: Reviewing Payments from the Kansas Universal Service Fund,* Legislative Division of Post Audit, State of Kansas, August 1999, at 6, 7, 17-20. *See also* Letter from James H. Lister, counsel for KCC, to David H. Krech, FCC, dated May 4, 1999 at 2; Letter from James H. Lister, counsel for KCC, to David H. Krech, FCC, dated May 11, 1999 (projecting that for the March 1999 to February 2000 period, 84 percent of KUSF funding would go exclusively to ILECs under the Rate Cut Funding program)

16 47 U.S.C. § 253

17 Petition for Preemption, Pursuant to Section 253 of the Communications Act, of Kansas Statutes and Rules that Discriminate Against New Entrants, filed by Western Wireless Corporation July 20, 1998 (Western Wireless Petition)

18 Western Wireless Petition at 1 (citing 47 U.S.C. §§ 253(a), 254(f))

19 Western Wireless Petition at 1 (citing 47 U.S.C. § 253(b))

comments.[20]

5. In late 1999 and early 2000, the KCC adopted a series of orders that substantially changed the operation of the KUSF. First, on September 30, 1999, the KCC adopted a forward-looking cost model for purposes of determining KUSF support for non-rural carriers (SWBT and Sprint).[21] This new mechanism replaces the previous mechanism with respect to these carriers, eliminating the "transitional" Rate Cut Funding program intended to offset reductions in intrastate access charges. Then, on December 29, 1999, the KCC affirmed its forward-looking cost model with some modifications, applied the model to SWBT and Sprint, and made several other decisions relating to the KUSF. Most relevant for purposes of the Western Wireless petition, the KCC held that on a going-forward basis, all KUSF funding would be fully portable to competing carriers; *i.e.*, if a competing carrier obtained a customer that was previously served by an ILEC, all funding that would previously have gone to the ILEC as a result of serving that line would instead be paid to the competing carrier. This principle of portability applies not only to the funding calculated for SWBT and Sprint under the new cost model, but also to the funding for rural ILECs that continues to be calculated under the High Cost Funding program and the previously non-portable Rate Cut Funding program.[22] Finally, on January 19, 2000, the KCC released an Order which, among other things, established a carrier assessment rate for SWBT that provides for universal service support at a level somewhat higher than would be calculated under the forward-looking cost model, but that preserves the principle of portability for all funding.[23] A similar settlement proceeding with Sprint remains pending.[24]

III. DISCUSSION

[20] The following parties filed comments in response to the Public Notice: Aerial Communications, Inc. (Aerial); AT&T Corp. and AT&T Wireless Services, Inc (AT&T); Bell Atlantic Mobile, Inc. (BAM); Cellular Telecommunications Industry Association (CTIA); Independent Telecommunications Group (ITG); Kansas Corporation Commission (KCC); Liberty Cellular, Inc. (Liberty); MCI Telecommunications Corp (MCI); Nextel Communications, Inc. (Nextel); Omnipoint Communications, Inc. (Omnipoint); Personal Communications Industry Association (PCIA); Southwestern Bell Telephone company (SWBT); Sprint Corporation (Sprint); Sprint Spectrum L.P.; State Independent Alliance (SIA); and United States Cellular Corp. (USCC). The following parties filed reply comments: Aerial; AirTouch Communications, Inc. (AirTouch); KCC; MCI WorldCom, Inc. (MCI WorldCom); Nextel; Omnipoint; SWBT; Sprint Spectrum; SIA; United States Telephone Association (USTA); and Western Wireless. In addition, the Local and State Government Advisory Committee (LSGAC) of the Commission recommended at its March 4, 1999 meeting that the Commission not preempt the provisions of the Kansas Act and 1996 KCC Order challenged by Western Wireless. FCC Local and State Government Advisory Committee, Advisory Recommendation Number 14, Petition of Western Wireless Corp., File No. CWD 98-90, adopted March 12, 1999. *Cf.* Letter from Michele C. Farquhar, counsel for Western Wireless, to Magalie Roman Salas, FCC, dated April 8, 1999 (responding to the LSGAC recommendation); Letter from Ken Fellman, LSGAC Chairman, to FCC Commissioners, dated May 11, 1999 (reaffirming LSGAC's recommendation).

[21] Order 10: "Establishing Assessment Rates for Year 2000 KUSF Contributions" KCC Docket No. 99-GIMT-326-GIT (September 30, 1999). The KCC based its new model on the Commission's forward-looking Proxy Cost Model, making some modifications to account for conditions specific to telecommunications providers in Kansas. *See* December 1999 KCC Order at 17, ¶ 26.

[22] December 1999 KCC Order at 84, ¶¶ J, K.

[23] Order 5: "Establishing Carrier Assessment Rate for Year 2000 KUSF Contributions" KCC Docket No 00-GIMT-236-GIT (January 19, 2000).

[24] *See* Kansas Docket No. 00-UTDT-455-GIT.

6. We conclude that Western Wireless' petition has been rendered moot by the December 1999 KCC Order. The gravamen of Western Wireless' complaint is that the Rate Cut Funding program, as previously structured, effectively prohibited the ability of non-ILECs to provide a telecommunications service by rendering them ineligible for the substantial support that was available only to ILECs in exchanges with more than 10,000 access lines.[25] The December 1999 KCC Order rectified this feature of the KUSF by making all funding, including Rate Cut Funding, fully portable. We therefore dismiss the Western Wireless Petition as moot.

7. In order to provide guidance on these critical universal service issues which may well arise in other contexts, however, we briefly discuss our concern that programs structured like the original Rate Cut Funding program could easily run afoul of section 253.[26] Section 253 provides the legal framework for preemption of a state statute or regulation that prohibits or has the effect of prohibiting the competitive provision of telecommunications service, which we have applied on a number of occasions.[27] In order to determine whether a section 253(a) violation has occurred, we must consider whether the challenged law, regulation or legal requirement "prohibit[s] or has the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service."[28]

8. We would be concerned about a universal service fund mechanism that provides funding only to ILECs.[29] A new entrant faces a substantial barrier to entry if its main competitor is receiving substantial support from the state government that is not available to the new entrant. A mechanism that makes only ILECs eligible for explicit support would effectively lower the price of ILEC-provided service relative to competitor-provided service by an amount equivalent to the amount of the support provided to ILECs that was not available to their competitors. Thus, non-ILECs would be left with two choices -- match the ILEC's price charged to the customer, even if it means serving the customer at a loss, or offer the service to the customer at a less attractive price based on the unsubsidized cost of providing such service.[30] A mechanism that provides support to ILECs while denying funds to eligible prospective competitors thus may give customers a strong incentive to choose service from ILECs rather than competitors. Further, we believe that it is unreasonable to expect an unsupported carrier to enter a high-cost market and provide a service that its competitor already provides at a substantially supported price. In fact, such a carrier may be unable to secure financing or finalize business plans due to uncertainty surrounding its state government-imposed competitive disadvantage. Consequently, such a program may well have the effect of prohibiting such competitors from providing telecommunications service, in violation of section 253(a).

25 *See* Western Wireless Petition at 10-11.

26 47 U.S.C. § 253

27 *See, e.g., Classic Telephone, Inc.*, 11 FCC Rcd 13082 (1996); *New England Public Communications Council*, 11 FCC Rcd 19713 (1996), *recon. denied*, 12 FCC Rcd 5215 (1997); *Pittencrieff Communications, Inc.*, 13 FCC Rcd 1735 (1997), *aff'd sub nom CTIA v. FCC*, 168 F.3d 1332 (D.C. Cir. 1999) (*Pittencrieff*); *Silver Star Telephone Company*, 12 FCC Rcd 15639 (1997) (*Silver Star*), *recon. denied*, 13 FCC Rcd 16356 (1998), *aff'd sub nom. RT Communications, Inc. v. FCC*, 201 F.3d 1264 (10th Cir. 2000); *Public Utility Commission of Texas*, CCB Pol 96-13 et al., FCC 97-346, 9 CR (P&F) 958 (released Oct. 1, 1997) (*Texas PUC*); *California Payphone Association*, 12 FCC Rcd 14191 (1997)

28 47 U.S.C. § 253(a).

29 *See Pittencrieff*, 13 FCC Rcd at 1751, ¶ 31.

30 *See* Western Wireless reply comments at 11.

9. If we find that a state requirement violates section 253(a), then we must determine whether it is nevertheless permissible under section 253(b).[31] The criteria set forth in section 253(b) preserve the states' ability "to impose, on a competitively neutral basis and consistent with section 254, requirements necessary to preserve and advance universal service . . . ."[32] We have held that a state program must meet all three of these criteria -- it must be "competitively neutral," "consistent with section 254," and "necessary to preserve and advance universal service" -- to fall within the "safe harbor" of section 253(b).[33] We have preempted state regulations for failure to satisfy even one of the three criteria.[34] If a requirement violates section 253(a) and does not fall within the safe harbor of section 253(b), the Commission must preempt the enforcement of the requirement in accordance with section 253(d).[35]

10. It appears doubtful that a program which limits eligibility for universal service funding to ILECs would be found competitively neutral, and thus within the authority reserved to the states in section 253(b). "[S]ection 253(b) cannot save a state legal requirement from preemption pursuant to sections 253(a) and (d) unless, *inter alia*, the requirement is competitively neutral with respect to, and as between, *all* of the participants and potential participants in the market at issue."[36] Because, as discussed above, a mechanism that offers non-portable support may give ILECs a substantial unfair price advantage in competing for customers, it is difficult to see how such a program could be considered competitively neutral. Moreover, a state requirement which otherwise violates section 253(b) cannot be saved merely because it is transitional.[37]

11. We further note that a program that provides universal service funding only to ILECs could well be found invalid under traditional preemption doctrine. A state or local provision may be preempted when, for instance, it conflicts with federal law or "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[38] Preemption may result not only from action

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[31] 47 U.S.C. § 253(b). *See, e.g.*, *Silver Star*, 13 FCC Rcd at 15655-56, ¶ 37; *Texas PUC* at ¶ 42. Section 253(c) sets forth additional situations, which are not present here, in which a state or local government requirement that violates section 253(a) may still be acceptable. 47 C.F.R. § 253(c).

[32] 47 U.S.C. § 253(b). Section 253(b) also preserves the states' ability to impose competitively neutral requirements that are necessary to protect the public safety and welfare, ensure the continued quality of telecommunications services, and safeguard the rights of consumers. *Id.* These provisions are not at issue here.

[33] *Pittencrieff*, 13 FCC Rcd at 1752, ¶ 33; *accord Silver Star*, 12 FCC Rcd at 15655-57, ¶¶ 37, 40.

[34] For example, in *Silver Star*, we preempted a Wyoming statute for its failure to satisfy the "competitive neutrality" criterion. 12 FCC Rcd at 15658-60, ¶¶ 42, 45.

[35] 47 U.S.C. § 253(d) ("If, after notice and an opportunity for public comment, the Commission determines that a State or local government has permitted or imposed any statute, regulation, or legal requirement that violates subsection (a) or (b), the Commission shall preempt the enforcement of such statute, regulation, or legal requirement to the extent necessary to correct such violation or inconsistency.")

[36] *Silver Star Reconsideration*, 13 FCC Rcd at 16361, ¶ 11 (emphasis in original).

[37] *See Silver Star*, 12 FCC Rcd at 15657, ¶ 39. We also would be concerned that non-portable support available only to ILECs may not be consistent with section 254 and necessary to preserve and advance universal service. Given the current posture of the case, however, we will not discuss these issues.

[38] *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 699 (1984), *citing Hines v. Davidowitz*, 312 U.S. 57, 67 (1941); *State Corporation Commission of Kansas v. FCC*, 787 F.2d 1421, 1425 (10th Cir. 1986). *See also*

taken by Congress, but also from a federal agency acting within the scope of its congressionally delegated authority.[39] We have previously held, in interpreting section 254 of the Communications Act,[40] that "competitive neutrality in the collection and distribution of funds and determination of eligibility in universal service support mechanisms is consistent with congressional intent and necessary to promote a procompetitive, de-regulatory national policy framework."[41] As discussed above, it is doubtful that a universal service funding program that restricts eligibility to ILECs could be considered competitively neutral. Thus, a program of this nature may well be found to be inconsistent with and to impede the achievement of important Congressional and Commission goals.

12. We decline to address in this order the other challenges to provisions of the KUSF that the parties raised.[42] These issues were not raised by Western Wireless in its petition and are beyond the scope of this proceeding.[43]

IV. CONCLUSION

13. In conclusion, we find that the orders adopted and implemented by the KCC in late 1999 and early 2000 have effectively rendered moot the significant issues of lawfulness raised by Western Wireless regarding the operation of the previously structured program. We therefore dismiss Western Wireless' petition as moot.

Louisiana Public Service Commission v. FCC, 476 U.S. 355, 368-69 (1986) (*Louisiana PSC*).

39 *Louisiana PSC,* 476 U.S. at 368-69, *citing Fidelity Federal Savings and Loan Assn. v. De la Cuesta,* 458 U.S. 141 (1982); *Capital Cities Cable, Inc. v. Crisp,* 467 U.S. 691.

40 47 U.S.C. § 254.

41 *Federal-State Joint Board on Universal Service,* Report and Order, CC Docket No. 96-45, 12 FCC Rcd 8776, 8801-02, ¶ 48 (1997), corrected by *Federal-State Joint Board on Universal Service,* Erratum, CC Docket No. 96-45, FCC 97-157 (rel. June 4, 1997), *aff'd in part, rev'd in part, remanded in part sub nom. Texas Office of Public Utility Counsel v. FCC,* 183 F. 3d 393 (5th Cir. 1999). To the extent that a state's universal service program, that is structured like the KUSF, involves matters properly within the state's intrastate jurisdiction under section 2(b) of the Act, those matters, if inseverable from the federal interest in promoting universal service in section 254, remain subject to federal preemption. *See Louisiana PSC; AT&T v. Iowa Utilities Board,* 119 S.Ct. 721, 730 (1999); *Texas Office of Public Utility Counsel v. FCC,* 183 F.3d at 423.

42 *See* Bell Atlantic Mobile comments at 4-5 (arguing that the Kansas Act provision limiting the amount of a carrier's KUSF contribution that it may collect from its customers to 8.89 % of the carrier's intrastate retail revenues violates section 332(c)(3) as applied to CMRS providers); CTIA comments at 8-9 (similar); AT&T comments at 1, 3-4 (arguing that KUSF conflicts with section 214(e) of the Communications Act); CTIA comments at 5-6 (similar).

43 We do note, however, that the limitation on passing through contributions to a carrier's retail customers expired on January 1, 2000. K.S.A. 1996 Supp. 66-2008(b). We further note that we have recently addressed in another proceeding issues concerning the application of section 214(e). Federal State Joint Board on Universal Service: Promoting Deployment and Subscribership in Unserved and Underserved Areas, Including Tribal and Insular Areas, *Report and Order*, CC Docket No. 96-45, FCC 00-208 (released June 30, 2000).

V. ORDERING CLAUSE

14. Accordingly, IT IS ORDERED that, pursuant to section 4(i) of the Communications Act of 1934, as amended, 47 U.S.C. § 154(i), and section 1.2 of the Commission's rules, 47 C.F.R. § 1.2, that this Memorandum Opinion and Order IS ADOPTED.

15. IT IS FURTHER ORDERED that the Petition for Preemption filed by Western Wireless Corporation IS DISMISSED as moot.

FEDERAL COMMUNICATIONS COMMISSION

Magalie Roman Salas
Secretary

STATEMENT OF COMMISSIONER HAROLD FURCHTGOTT-ROTH, CONCURRING IN PART AND DISSENTING IN PART

Re: *Western Wireless Corporation Petition for Preemption of Statutes and Rules Regarding the Kansas State Universal Service Fund Pursuant to Section 253 of the Communications Act of 1934*, File No. CWD 98-90.

As the Commission correctly recognizes, Western Wireless's petition is moot. The Kansas Corporation Commission has completely altered its regulatory scheme for determining and allocating universal service support to carriers in Kansas. Western Wireless's petition must therefore be dismissed as moot, and I concur in this aspect of the order.

Why the Commission thinks it necessary to devote an additional five or six pages of this order to a discussion of why it would preempt the Kansas regulations if they were still in effect is beyond me. The Commission vaguely asserts its advisory opinion is necessary "to provide guidance" on universal service issues, based on its wholly unsupported assertion that these issues "might well arise elsewhere." Tellingly, the Commission cannot point to a single state commission that has even suggested it would adopt requirements similar to the Kansas Commission's.

I therefore dissent from those aspects of this order that purport to interpret section 253(d). Although this agency – unlike Article III federal courts – may have the power to render advisory opinions in some circumstances, I think it exceedingly unwise for it to make such determinations in connection with section 253(d). In my view, in making this statement, the Commission disregards basic principles of federal-state comity and insults the Kansas Commission, which has itself corrected whatever infirmity may have existed in its previous rules.

The 1996 Act contemplates that state commissions will play an important part in bringing competition to the local exchange markets, and it gives states freedom to fashion regulatory approaches that supplement the Act's federal requirements. *See, e.g.*, 47 U.S.C. § 253(b). This Commission may interfere with a state commission's requirements only pursuant to section 253(d). An examination of that provision is instructive. It states that if the Commission "determines that a State or local government *has permitted or imposed* any statute, regulation, or legal requirement that violates [section 253(a) or (b)], the Commission shall preempt the enforcement of such statute, regulation, or legal requirement to the extent necessary to correct such violation or inconsistency." 47 U.S.C. § 253(d) (emphasis added). The provision is drafted in the present tense, and I therefore question whether we may legally make section 253(d) determinations on state commission rulings that do not exist. Moreover, given that no regulation currently exists, a Commission ruling is most assuredly not "necessary to correct" the Kansas Commission's approach to implementing the Act's universal service provisions.

In any event, I believe that comity concerns alone are enough to prevent us from reaching out to strike down nonexistent state regulations, simply in order to dictate to states the "proper" way for them to conduct their business. We must not forget that Congress charged both this Commission *and* the state commissions with implementing the 1996 Act, and we should keep our interference in the business of the states to a minimum.

EXHIBIT B

BACKGROUND FOR ALTERNATIVE POLICY CONSIDERATIONS

Economists and other industry experts have long advocated that carriers should compensate one another for the exchange of all traffic at the same rate level, i.e., *a minute is a minute is a minute*. Today, however, technology, markets and federal regulatory policy have converged and in doing so, have had profound effects on consumers. At the same time, certain state laws and regulations pertaining to intercarrier compensation are outmoded and harmful to competition. Technology and telecommunications markets are pushing toll prices to the forward-looking long-run costs of the facilities used to provide that service. Consequently "distance" has almost ceased to be a function of the cost of usage. Consistent with this reality, federal regulatory policy has over time enabled the market phenomenon termed "all-distance calling". In the relatively non-competitive wireline local markets (including intrastate toll services), however, inefficient pricing persists.

Technological Advance and the "Death of Distance"

The modern digital telecommunications networks – owing to technological advances over the past two decades – have revolutionized communications. Technological advances in fiber optics for transmission systems yielding enormous gains in speed, efficiency, and operating cost; and improved switching technologies that produce what are essentially non-blocking switching machines coupled with vastly improved processor capacity, have reduced the cost of telephone usage (i.e., minutes) to a mere fraction of one cent per minute of use. As a result, both the long distance wireline and wireless service markets are characterized by intense competition because distance-sensitive rates have essentially disappeared in interstate long distance price structures.

Federal Regulatory Policy Has Created a New Wholesale Paradigm That is Beyond The Purview of State Regulators

Certain federal policy pronouncements converged over time to provide wireless carriers with an advantageous wholesale framework from which all-distance calling began to dominate telecommunications markets in 1999. More importantly, between the passage of the Telecommunications Act of 1996 and the FCC's *Eighth Report* released in July 2003, the wireless industry's proportion of total industry revenue rose from a mere 5% in 1996 to a whopping 30% in 2002.[1] The rise of wireless minutes in large measure is a result of the ability of wireless carriers to largely avoid above-cost switched access charges and thereby under-price traditional long-distance, wireline service providers, that continue to pay above-cost switched access charges. In a series of interrelated policy and regulatory decisions, starting with the preemption of state CMRS regulation, the FCC and Congress provided a framework for intercarrier compensation (i.e., the wholesale framework) across the nation that:

- Recognizes that distance as a determinate of switched access pricing is *diminimus* and in some cases zero;
- Establishes geographic calling scope for local traffic that transcends the boundaries of the state of Alabama;
- Erases the traditional distinction in Alabama between local and toll calling; and
- Shields the wireless sector from intrastate switched access pricing.

In particular, the exchange of intraMTA traffic at reciprocal compensation rates, rather than the access regime associated with LATAs, has provided wireless carriers a

[1] In the Matter of Implementation of Section 6002(b) of the Omnibus Budget and Reconciliation Act of 1993; Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services, *Eighth Report*, WT Docket No. 02-379 (released July 14, 2003) at para. 102.

cost advantage that is not available to wireline carriers in Alabama. Wireless providers are not required to pay the intrastate access charges that traditional wireline toll service providers are required to pay. This is because the MTA functions as the local calling area for wireless carriers, thus allowing wireless carriers to avoid paying intrastate access charges for calls completed within the wide expanse of a defined MTA. Wireless carriers, therefore, have essentially eliminated distance as a pricing element and the ensuing advent of the all-distance calling plans offers consumers the ability to manage toll expense such that interLATA and intraLATA toll can be avoided altogether.

This is not a bad thing, so long as all carriers are placed on equal footing. That is not the case, however, and all wireline carriers are losing minutes, especially toll minutes (and the corresponding access revenue to the ILECs as well), to wireless. Access rate reform that would serve to preserve wireline toll usage in general has been too slow in coming and the result has been irreparable harm to IXCs.

Despite the loss of minutes, for the most part customers are not turning in their landline phones. The latest FCC statistics for Alabama indicates that household wireline penetration rates have increased between 1984 and 2003, from 88.4% to 91.7%.[2] In other words, there is no evidence that the rural ILECs are losing access line revenue.

However, "wireless minute substitution" is occurring and wireless penetration rates back this up. Wireless penetration rates are a function of total population based on census data, referred to a POPs. The wireless penetration rate in the U.S. today is 56%.[3]

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[2] *Trends in Telephone Service*, FCC Industry Analysis and Technology Division, Wireline Competition Bureau, May 2004, Table 16.2.

[3] *Global Wireless Matrix 1Q04: Quarterly Update on Global Wireless Industry Metrics*. Merrill Lynch Global Research & Economics Group, Global Fundamental Equity Research Dept. July, 2004.

The population of the state of Alabama is estimated to be 4.5 million.[4] Thus, for purposes of measuring wireless penetration rates, there are 4.5 million POPs in Alabama. According to the FCC, the number of wireless subscribers in the state is 1.9 million.[5] The wireless penetration rate in Alabama is, therefore, 42% (1.9/4.5 = 42%). Absent a discernable drop in the household wireline penetration rate, however, it is only reasonable to conclude that wireless substitution is, in the main, eroding toll minutes, almost surely intrastate toll minutes given their significantly higher cost. That is, the lack of reform of the intrastate switched access charge regime has driven minutes, hence revenue, off the wireline network and onto the wireless network and thereby placed wireline carriers in a deteriorating competitive position.

The Rise of All-Distant Markets

At least three generic variants of the so-called retail "bundled" or "all-distance" offer are relevant for consideration regarding this issue: 1) Wireless all-distance plans, 2) Wireless/Wireline bundles, and 3) Wireline local/toll bundles. Although all-distance calling has characterized the wireless industry form its inception, technological advance coupled with federal policy making has enabled all-distance calling at retail prices that are affordable for mass-market consumers in the U.S. It follows that as conditions permit, consumers will gravitate away from unnecessary costs that are the remnants of outdated pricing policies.

The hybrid wireline/wireless has emerged and it, too, is providing consumers with the option to manage telecommunications expense. Many ILECs responded to the toll threats posed by wireless by reducing their intraLATA toll retail rates and offering

4 http://www.quickfacts.census.gov/qdf/states/01000.html

5 *FCC 8th Report*, Appendix D, Table 2.

bundled rate offerings that do the same. All of these plans offer freedom from distance as a determinant of the cost of usage or minutes. At the same time, wireline competitors are strapped with the worst vestige of distance-specific regulation, i.e., above-cost access charges.

Toll-Centric Reform

There is a viable policy option that can be implemented to synchronize state and federal regulatory regimes with the emergent network of all-distance markets. Consistent with the charge from Congress to "promote competition and reduce regulation",[6] the appropriate action for this Commission is to expeditiously reform that which resides within its authority under federal and state law to ensure that Alabama's competitive landscape is as technologically and competitively neutral as is possible.

An alternative to the underlying assumption that recovery of lost access revenue must be provided is the toll-centric alternative. Under this option, instead of recovering lost access revenue through local rate increases, local carriers are *permitted* to recover lost revenue – to the extent they deem necessary – via a new *retail* charge applicable to their own local subscribers that make toll calls. This option has the advantage of being market-based, able to be competed away, politically feasible and consistent with the 1996 Act's mandate to remove implicit subsidies.

Thus, for example, the rural ILECs would have the ability to recover whatever lost access revenue it deems necessary from its local ratepayers that make toll calls today through a new "retail" access rate. This is exactly the course of action any carrier operating in a competitive marketplace would undertake.

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[6] Telecommunications Act of 1996. The full text of the general purpose of the 1996 Act is "to promote competition and reduce regulation to secure lower prices and higher quality services for all American telecommunications consumers and encourage the rapid development of new telecommunication services."